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Overview: In this 50th issue of showCASE, our experts take a closer look at what appears to be Poland's successful struggle to close the VAT Gap. We also examine a region where VAT is only planned to be introduced (the Persian Gulf) and analyze the expected changes to fiscal regimes in the Gulf Cooperation Council.

Poland's Ambitious Plans for Fighting VAT Fraud

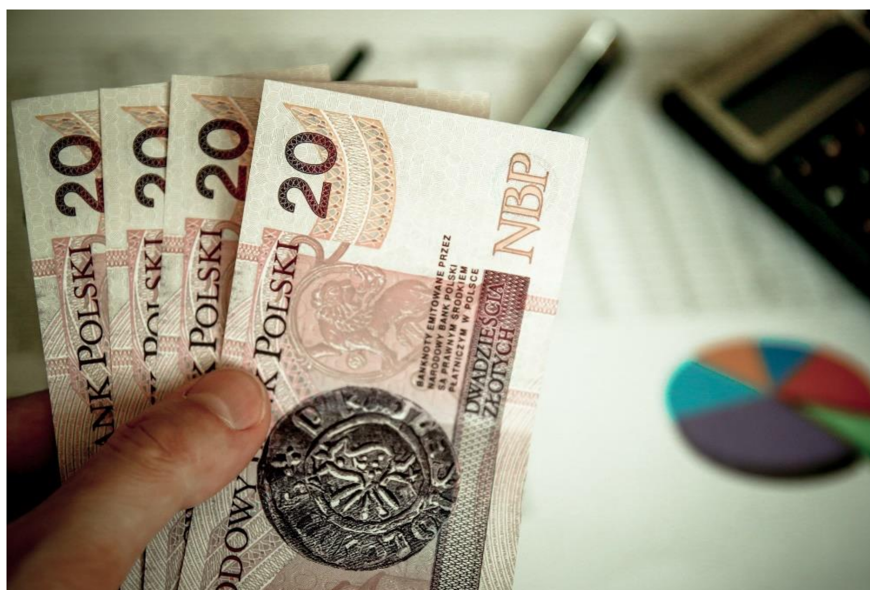
By: *Grzegorz Poniatowski, Director of Fiscal Policy Studies at CASE; Monika Rębała, CASE Communications Officer*

This month, Pierre **Moscovici**, Commissioner for Economic and Financial Affairs, Taxation and Customs, bluntly stated:

> *Twenty-five years after the creation of the Single Market, companies and consumers still face 28 different VAT regimes when operating cross-border. Criminals and possibly terrorists have been exploiting these loopholes for too long, organizing a EUR 50 billion fraud per year. This anachronistic system based on national borders must end.*

In order to deal with this perceived problem, specific changes to the *VAT Directive* should be announced in coming months. The Commission hopes that, if everything goes according to plan, a new system could be implemented in 2022.

However, the European Commission is not the only organ that has declared war against VAT fraud, but some Member States have made increasing VAT compliance a key priority as well. The Polish Ministry of Finance, for example, expects (and needs) to see significant success in this realm. According to the Ministry, for 2017 VAT revenues will increase to 150 billion zlotys, while in 2018, 166 billion zlotys are expected as incomings. According to CASE calculations, should this optimistic forecast comes true, the VAT gap (the difference between VAT revenues expected by government and those actually collected) will decrease by 17 % in 2017 and by a further 13 % in 2018.



Source: Pixabay

Achieving this result in Poland would undoubtedly be a huge success, as over the years the country has been among the EU countries with the biggest VAT gap. According to the latest CASE report prepared for the European Commission and published in September 2017, the VAT gap increased from just a few percent in 2007 to 25% (approximately 40 billion zlotys) in 2015 (with only Romania, Slovakia, Greece, Lithuania and Italy having worst results). In turn, the amount of VAT returns has been increasing much faster than VAT revenues in the state budget. The ratio between VAT returns and VAT revenues amounted to 35.9% in 2008 and 41.6 % in 2015. The main reason for this result was likely the increase in "missing trader" fraud in intra-EU transactions, a scheme where at some stage a broker effectively reclaims VAT not paid by a missing trader.

Given this reality, how does the Polish government plan to fight VAT non-compliance? The parliament has already implemented a few laws designed to clamp down on tax evasion and tax fraud, including:

- Implementing the Standard Audit File for Tax, which involves a permanent electronic exchange of financial information between the taxpayer and the tax authorities;

- Eliminating the possibility of quarterly settlement of VAT for taxpayers other than small ones. Also, newly established entities will not have the possibility to file VAT returns quarterly in the first twelve months of their activity; and

- Implementing the so-called fuels legislative package, under which each importer of fuel, gas or oil from another EU member state has to pay VAT within five days of the product arriving in Poland. Permits for fuel trade are issued only to an entity located in Poland or foreign companies which have a unit registered in Poland.

These changes to the laws have already showed some results. Given the increase in VAT revenues tracks a decrease in VAT returns, we can infer that VAT evasion in cross-border trade in Poland has almost been eliminated. According to the Ministry of Finance, the amount of VAT returns reached 45.77 billion zlotys in first six months of 2016. In the first half of 2017, in turn, Vat returns reached 37.84 billion zlotys, which made up 32.11 % of VAT revenues, and was lower than in 2008, when not many people knew about the so-called "carousel fraud," a specific type of missing trader fraud.

The fight against VAT fraud will not be an easy to win both in Poland and at the EU-wide stage. The fact that it is the first overhaul of the tax regime in 25 years indicates that reaching a consensus on tax reform among all EU countries will be challenging task. Currently, within the EU, cross-border trade between Member States is zero-rated, with tax only due when the goods reach purchasers. The Commission wants companies that sell goods to companies based in another EU member State, to pay VAT at the point of sale and at rates determined by the VAT rates in the destination country. Member States will collect VAT on behalf of each other and later pay them back to each other directly. Is there enough of trust among European countries to agree on this? The Commission wants also to create a single online web portal, named "a one-stop shop". Traders will be able to make declarations and payments using it in their own language and according to the same rules and administrative templates as in their home country.

Very optimistic numbers concerning VAT revenues and returns in 2017 indicate that Polish government has been thus far successful in a fight against VAT fraud. However, what they also show is that further improvement in VAT collection will be a huge challenge. According to the Ministry of Finance, a significant decline in the VAT gap in 2018 will be possible thanks to the aforementioned extension of the Standard Audit File for Tax, implementing a risk *assessment* system, and implementing split payments (where a VAT payment is secured on a special VAT bank account). But to reach a VAT gap below 13%, the government will not only need to fight more strenuously against evasion but also to reduce the "grey zone;" that is, eliminating non-register transactions, a battle far more complicated than fighting the VAT fraud.

VAT, GCC Style

By: *Katarzyna Sidło, Political Economist at CASE*

Introduction of a standard VAT (Value Added Tax) rate of 5% was agreed on by the Gulf Cooperation Council (GCC) countries of Bahrain, Kuwait, Oman, Qatar, Saudi Arabia, and the United Arab Emirates (UAE) back in June 2016. And while the future of the GCC itself is currently not certain, due mainly to the ongoing feud between Qatar and the remaining members of the club, the process of introduction of the new tax regime is to begin according to plan. Saudi Arabia's General Authority of Zakat and Tax (GAZT) confirmed the implementation of the new tax laws starting from January 1, 2018, while the remaining countries of the GCC have until the end of the year to follow suit.

The move is part of an effort on the part of GCC authorities to diversify their sources of income and become less reliant on oil revenues, which amounted to between 50% and 90% of revenues of the GCC countries from 2012 to 2015. While currently Crude Oil Brent is up to USD 60.69 per barrel, this still amounts to only around a half of its 2014 peak, and historically prices have been volatile enough to counsel governments not to over-rely on them. Such a message has not been heeded, although this new approach to taxation might suggest a change.

Source: Flickr, Citizen59

The centerpiece of the VAT regime is a 5% threshold, relatively low by EU standards – it amounts to roughly 20% on the average, between 18% in Luxembourg and 27% in Hungary – it is expected to significantly aid strapped state budgets within the GCC. In implementing such a threshold, the GCC countries follow the suggestion of the International Monetary Fund (IMF) to "start at low rates (…) [to] encourage the design of simple and broad based taxes which are easier to administer and will have little or no efficiency costs and not stand in the way of efforts to diversify the economy." The advice is valuable even more so as the planned changes are not uncontested. Only yesterday (October 29, 2017) in Kuwait, some members of the National Assembly reportedly threatened to "grill the finance minister" should the VAT be implemented and the public attitude towards the changes cannot be expected to be overly optimistic.

Despite a low threshold, in Saudi Arabia, introduction of the VAT is projected to contribute to the budget an amount equal to about 1.6% of the Kingdom's GDP annually. In Kuwait, it is estimated to bring additional KD 600 million to the country's budget. More importantly, however, is the cultural shift that such a policy may create. Thus far, the Gulf monarchies have been functioning under the understanding that governments provide citizens (and citizens only, foreigners residing in the GCC were by no means treated with the same kind of "generosity") with largesse in return for compliance and acquiescence. Introduction of VAT and other taxes (such as excise that are contemplated or already

in force, e.g. in UAE) will therefore not only require creation of a tax culture but also redefinition of the social contract underlying the functioning of the GCC societies.

While move towards the introduction of VAT may help these governments move beyond their addiction to extractive rents, it may prove extremely challenging. Governments will need to build administrative capacity, conduct educational campaigns among entrepreneurs (78% of whom were in July 2017 “concerned” about the introduction of VAT according to a Deloitte survey), and reason with their citizens. It seems that Gulf residents will soon learn firsthand what most of the world is already painfully aware of: nothing in this world is certain but except death and taxes.

This week: The government plans to introduce a partial Sunday trading ban from the beginning of 2018, with most shops forced to close every second and fourth Sunday of the month. According to preliminary estimates, the partial Sunday trading ban will result in shopping mall revenue falling by PLN 4.6 billion/year, resulting in 19,000-20,000 redundancies. Poland's budgetary revenues from taxes are expected to decrease by PLN 890 million.

GDP (Q2 2017, est.)

4.4% y/y

Up from 4.2% in Q1

Inflation (Sep 2017)

2.2% y/y

Up from 1.8% in Aug

Unemployment (Sep 2017)

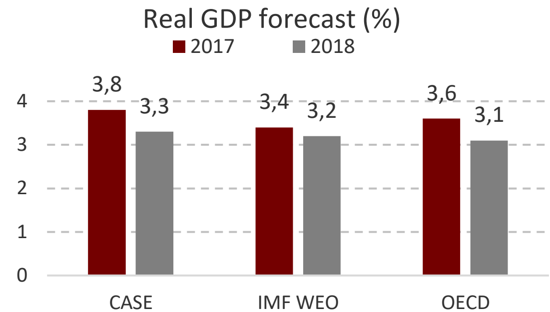
6.8%

Down from 7.0% in Aug

NBP Base rate

1.5%

From 2% Mar 2015



This week: On the occasion of the Eurasian Intergovernmental Council held in Armenia last week, Prime Minister Medvedev discussed economic relations between Russia and Armenia with his Armenian counterpart, Mr. Karen Karapetyan. Among the topics was a free economic zone at the border between Armenia and Iran. Mr. Medvedev declared that Russia is ready to take part in building of the zone through the use of Russia's development institutions.

GDP (Q2 2017)

2.5% y/y

Up from 0.5% in Q1

Inflation (Sep 2017)

3.0% y/y

Down from 3.3% in Aug

Unemployment (Sep 2017)

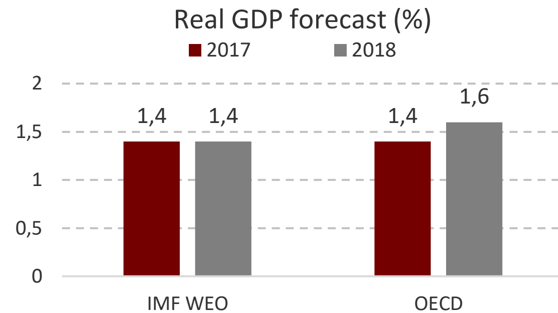
5.0%

Down from 4.9% in Aug 2017

CBR Base rate

8.25 %

From 8.5% in Oct 2017



This week: Since August 2017, the insolvent Air Berlin, founded in 1978, has ceased its flight operations. Lufthansa will take over around 80 out of its 130 aircraft, as well as around 3,000 out of its 8,000 employees. Negotiations with other prospective buyers such as Easy jet and Thomas-Cook daughter Condor are still ongoing.

GDP (Q2 2017)

2.1% y/y

Up from 2.0% in Q1

Inflation (Sep 2017)

1.8% y/y

From 1.8% in Aug

Unemployment (Aug 2017)

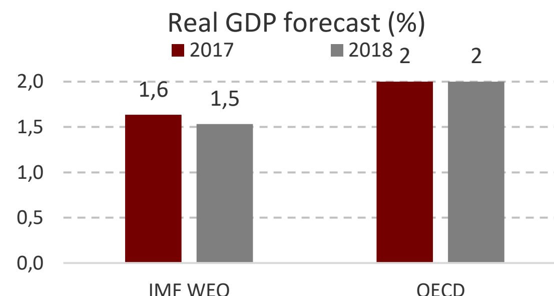
3.7%

Up from 3.6% in July

ECB Deposit rate

-0.4%

From -0.3% Dec 2015



This week: Ukrainian lawmakers voted in favor of the health system reform, aimed at raising standards and decreasing the omnipresent corruption in the health sector. A crucial element will be an increase in budgetary spending on healthcare by 12% per annum. However, experts emphasize that, in order to improve the situation in healthcare sector, raises in wages of healthcare professionals must be introduced alongside the reform as well.

GDP (Q2 2017)

2.3% y/y

From 2.5% in Q1

Inflation (Sep 2017)

16.4% y/y

Up from 16.2% in Aug

Unemployment (Q2 2017)

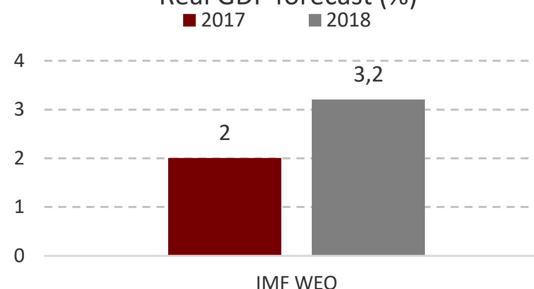
9.1%

Down from 10.5% in Q1 2017

NBU Base rate

13.5%

From 12.5% in Sep 2017



This week: A second call for subsidy allocation to households to install new boilers is finding strong support. A budget of 3.5 billion of Czech crowns from EU funds has been made available for the purpose of exchanging around 35,000 boilers. In contrast to previous calls, financing will not be granted for coal or combined coal/biomass burning boilers. Preliminary evidence indicates the strongest demand will be for gas-condensing and combined types.

GDP (Q2 2017)

4.7% y/y

Up from 3.0% in Q1 2017

Inflation (Sep 2017)

2.7% y/y

Up from 2.5% in July

Unemployment (Q2 2017)

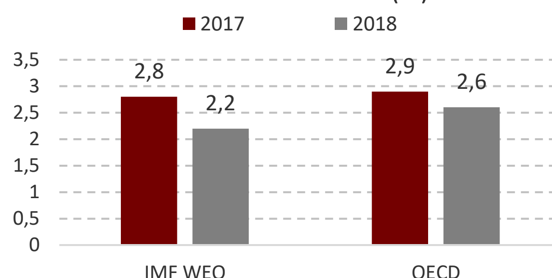
3.0%

Down from 3.4% in Q1

CNB Base rate

0.25%

From 0.05% (4 August 2017)



This Week: During his speech at the 17th World Export Development Forum (WEDF) in Budapest, Minister of Foreign Affairs and Trade Péter Szijjártó stressed the role of small and medium-sized companies in the country's exports. He assured that the government is going to support SMEs on international markets in order to 'rapidly increase the weight of SMEs in exports'.

GDP (Q2 2017)

3.2% y/y

Down from 4.2% in Q1

Inflation (Sep 2017)

2.5% y/y

Up from 2.1% in July

Unemployment (Q2 2017)

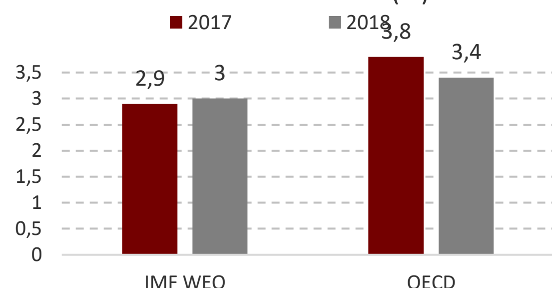
4.2%

Down from 4.3% in Q1

MNB Base rate

0.9%

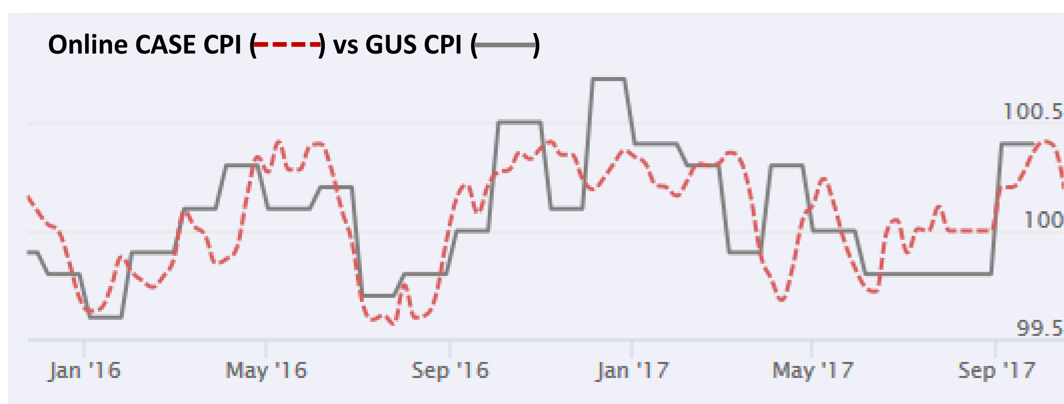
From 1.05% May 2016



The weekly online CASE CPI

The online CASE CPI is an innovative measurement of price dynamics in the Polish economy, which is entirely based on online data. The index is constructed by averaging prices of commodities from the last four weeks and comparing them to average prices of the same commodities from four weeks prior. The index is updated weekly.

Our weekly online CASE CPI



Monthly CASE forecasts for the Polish economy

Every month, CASE experts estimate a range of variables for the Polish economy, including future growth, private consumption, and foreign trade, current account balance, and the CPI.

CASE economic forecasts for the Polish economy
(average % change on previous calendar year, unless otherwise indicated)

	GDP	Private consumption	Gross fixed investment	Industrial production	Consumer prices
2017	3.8	4.3	2.7	4.3	1.9
2018	3.3	3.3	3.1	3.7	2.1
	Nominal monthly wages	**Merchandise exports (USD, bn)**	**Merchandise imports (USD, bn)**	**Merchandise trade balance (USD, bn)**	**CA balance (USD, bn)**
2017	5.1	201.6	201.8	-0.2	-4.7
2018	3.5	211.3	213.1	-1.8	-5.9

For more information on our weekly online CASE CPI, please visit: http://case-research.eu/en/online-case-cpi
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